THE CITY OF SAN DIEGO

MANAGER'S REPORT

DATE ISSUED: December 3, 2002 REPORT NO. 02-291

ATTENTION: Committee on Rules, Finance and Intergovernmental Relations
Agenda of December 4, 2002

SUBJECT: LM 6000 Power Generating Turbines

SUMMARY

Issue – Should the City of San Diego continue negotiations to accept two LM 6000 gas turbines from the State of California?

Manager's Recommendations –

1. Direct the City Manager to continue negotiations to accept the LM 6000 gas turbines along with, at a minimum, sufficient funds provided by the State of California, Attorney General's Office, to transport, store and maintain the units in warranty condition.

2. Direct the City Manager to decline the power purchase agreement offered by the California Department of Water Resources.

3. Direct the City Manager to return to this committee in 60 days with final recommendations for the acceptance and beneficial use of the LM 6000's in the San Diego Region including options for joint development with other agencies.

Other Recommendations – None

Fiscal Impact – None with this action. It is anticipated that the State of California Attorney General's Office will fund the cost associated with maintaining and storing the units until the City determines a beneficial use of the units. There is a potential benefit to the City of at least $5 million if the units cannot be developed into a power plant and are sold.

BACKGROUND

As California's deregulated electricity market collapsed under the weight of high wholesale prices, the State of California entered into intermediate and long term power delivery contracts with numerous electricity generating companies. The State later brought suit against some of those companies to cancel or renegotiate their contracts. Recently, the Williams Company agreed to pay more than $400 million and to renegotiate a $4.3 billion contract entered into with the State at the peak of the energy crisis. As a part of the settlement agreement, the State received six LM 6000 electric generating turbines. The State determined that these electric generation units could provide benefit to the regions most impacted by power shortages during the energy crisis. The San Diego and San Francisco regions were determined to be the most appropriate locations for the siting of the additional peak load generating capacity provided by the LM 6000 units.

DISCUSSION

As directed by Rules Committee on November 20, 2002, staff continued its negotiations with representatives from the State to obtain the transfer of two LM 6000 power generating units to the City of San Diego. The three draft agreements proposed by the State (the Power Purchase Agreement, Implementation Plan, and Escrow Agreement) are provided as attachments to this report.

The State of California's proposal would transfer two LM 6000 power generators to the City under conditions stipulated in the Implementation Plan. The City's responsibility would be to develop the two power generators into a peaker power plant. All development and permit costs would be reimbursed by the State Attorney General's Office as detailed in the Escrow Agreement. Upon completion of the power plant's construction and when the plant is ready for commercial operation, the Power Purchase Agreement would provide monthly capacity fee payments designed to offset all fixed and variable operating costs and the debt service for any bonds issued to construct the plant. The term of the proposed power purchase agreement is ten years. The City of San Diego would receive the full benefit of the asset value and any energy generated by the plant after the ten year power purchase agreement ended.

The City's continuing negotiations with the State has not yet resulted in a power purchase agreement that would eliminate risk to the City. Negotiations are continuing and the latest information will be provided at Rules Committee meeting on December 4, 2002. Since the last report to the Rules Committee, the State has proposed adding a provision to the Power Purchase Agreement that would automatically terminate it, without any financial recourse by the City for its costs, if the State's Settlement Agreement with Williams Brothers is terminated for any reason. Staff now recommends declining the DWR power purchase agreement because of the uncertainty and risk imposed by this new provision.

All agreements presented for consideration provide the City with the option for "Sale of Assets", if the City determines key approvals cannot be obtained or that the acquisition and construction of the facility would result in an unacceptable risk to the City. The City could then sell the units to either the California Power Authority or through a public bidding process, and would be allowed to retain a portion of the proceeds with the remaining proceeds from such sale being deposited in the State of California Electric Power Fund.

ALTERNATIVES

1. Do not continue negotiations with the State of California Department of Water Resources.

2. Accept the Power Purchase Agreement as proposed.

Respectfully Submitted,

Tom Blair
Energy Administrator

Richard L. Hays
Environmental Services Director

Approved: George I. Loveland
Senior Deputy City Manager

HAYS/RAE/TB

Attachments:
1 Power Purchase Agreement
2 Implementation Plan
3 Escrow Agreement